

# FTC Consumer Alert

Federal Trade Commission • Bureau of Consumer Protection • Office of Consumer and Business Education

## Need a Loan? Think Twice About Using Your Home as Collateral

**I**f you need money to pay bills or make home improvements, and think refinancing, a second mortgage, or a home equity loan is the answer—consider your options carefully. If you can't make the required payments, you could lose your home as well as the equity you've built up. Don't let anyone talk you into using your home to borrow money you don't really need.

Not all loans or lenders are created equal. Some unscrupulous lenders target elderly and low-income homeowners and those with credit problems. These lenders may offer loans based on the equity in your home, not your ability to repay the loan. High interest rates and credit costs can make borrowing money using your home very expensive.

**Consult with your attorney, financial advisor, or someone else you trust before making any loan decisions.**



### Early Warning Signs

Avoid any lender who:

- tells you, or requires you, to falsify information on the loan application. For example, the lender tells you to say your loan is primarily for business purposes when it's not.
- pressures you into applying for a loan or applying for more money than you need.
- pressures you into accepting monthly payments you can't make.
- fails to provide required loan disclosures or tells you not to read them.
- misrepresents the kind of credit you're getting. For example, calling a one-time loan a line of credit.
- promises one set of terms when you apply, and gives you another set of terms to sign—with no legitimate explanation for the change.
- tells you to sign blank forms—the lender says they'll fill them in later.
- says you can't have copies of documents that you've signed.

You can take some steps to protect your home and your equity. Here's how.

## **1. Shop Around. Costs can vary greatly!**

Contact several lenders—including banks, savings and loans, credit unions, and mortgage companies. Ask each lender about the best loan for which you qualify. Compare:

- **The annual percentage rate (APR).** The APR is the single most important thing to compare when shopping for a loan. It takes into account not only the interest rate, but also points, mortgage broker fees, and certain other credit charges the lender requires the borrower to pay, expressed as a yearly rate. Generally, the lower the APR, the lower the cost of your loan. Ask if the APR is fixed or adjustable—that is, will the APR change?
- **The term of the loan.** How many years will you make payments on the loan?
- **The monthly payment.** What's the amount? Will it stay the same or change?
- **Is there a balloon payment?** This is a large payment usually at the end of the loan term, often after a series of low monthly payments. When the balloon payment is due, you must come up with the money. If you can't, you may need another loan, which means new closing costs.
- **Is there a prepayment penalty?** These are extra fees that may be due if you pay off the loan early by refinancing or selling your home. Prepayment penalties may force you to keep a high-rate loan by making getting out of the loan too expensive. Try to negotiate this penalty out of your loan agreement.
- **Will the interest rate for the loan increase if you default?** An increased interest rate provision says that if you miss a payment or pay late, you may have to pay a higher interest rate for the rest of the loan term. Try to negotiate this provision out of your loan agreement as well.
- **Does the loan include a charge for any type of credit insurance, such as credit life, disability, or unemployment insurance?** Is the credit insurance required as a condition of the loan? If not, how much lower would your monthly payment be without the credit insurance? Before deciding to purchase voluntary credit insurance from a lender, think about whether you really need the insurance and check with other insurance providers about their rates.



### **Good Faith Estimate**


Lastly, ask each lender to provide, as soon as possible, a written “good faith estimate” that lists all charges and fees you must pay at closing. Although not always required, these estimates make it easier to compare terms from different lenders.

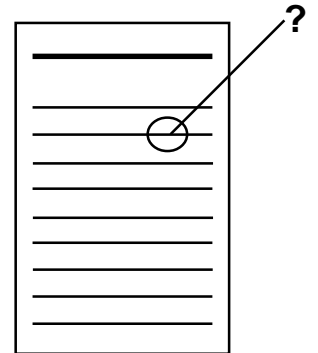
## **2. After Choosing a Lender**

- **Negotiate.** It never hurts to ask if the lender will lower the APR, take out a charge you don't want to pay, or remove a loan term that you don't like.
- **Ask the lender for a blank copy of the form(s) you'll sign at closing.** While they don't have to give you blank forms, most legitimate lenders will. Take the forms home and review them with someone you trust. Ask the lender about items you don't understand.

- **Ask the lender to give you copies of the actual documents** you will be asked to sign as soon as possible. While a lender doesn't have to give you all of the actual filled-in documents before closing, it doesn't hurt to ask.
- **Be sure you can afford the loan.** Figure out whether your monthly income is enough to cover each monthly payment in addition to your other monthly bills and expenses. If it isn't, you could lose your home—and your equity—through foreclosure or a forced sale.

### **3. At Closing**

- Before you sign anything, ask for an explanation of any dollar amount, term, or condition that you don't understand.
- Don't sign a loan agreement if the terms differ from what you thought they would be. For example, a lender should not promise a specific APR and then—without good reason—increase it at closing.
- Make sure you get a copy of the documents you signed before leaving the lender. They contain important information about your rights and obligations.
- Don't initial or sign anything saying you're buying voluntary credit insurance unless you really want to buy that insurance.



#### **High-Rate, High-Fee Loans**

**The Home Ownership and Equity Protection Act (HOEPA)** may give you additional rights if your loan is a home equity loan, second mortgage or refinance secured by your principal residence and if:

- the loan's APR exceeds by more than 10% the rate on a Treasury note of comparable maturity, *or*
- the total fees and points at or before closing exceed the larger of \$451 or 8% of the total loan amount. (The \$451 figure is for 2000 and is adjusted annually.)

#### **If HOEPA applies:**

- A lender may not engage in a pattern or practice of lending based on home equity without regard to the borrower's ability to repay the loan.
- You must get certain disclosures from the lender at least three business days before closing.
- Your lender cannot make a direct payment to a home improvement contractor.
- Certain loan terms are illegal—such as most prepayment penalties and increased interest rates at default.
- In most situations, your loan cannot have a balloon payment due in less than five years.

**A high-rate or high-fee loan might be right for you, but be aware of the risks. These loans are extremely expensive ways to get money. You could lose your home if you can't make the payments.**

#### **4. After Closing**

Having second thoughts about the loan? **The Truth in Lending Act** gives most home equity borrowers at least three days *after* closing to cancel the deal. This is known as your right of “rescission.” In some situations (consult with your attorney), you may have as much as three years to cancel. To rescind, you must notify the creditor in writing. After you rescind, the lender has 20 days to return all money or property you paid to anyone as part of the credit transaction and release any security interest in your home. You must then offer to return the creditor’s money or property, which may mean getting a new loan from another lender.

#### **Where to Complain**

If you think your lender has violated the law or you want information about a right to rescind, contact a private attorney or the Federal Trade Commission. You can file a complaint with the FTC by contacting the Consumer Response Center by phone, toll-free at: 1-877-FTC-HELP (382-4357); TDD: 202-326-2502; by mail: Consumer Response Center, Federal Trade Commission, Washington, DC 20580; or by email: use the complaint form at [www.ftc.gov](http://www.ftc.gov). Although the Commission cannot resolve individual problems for consumers, it can act against a company if it sees a pattern of possible law violations.

#### **For More Information**

The FTC publishes a series of free brochures on credit and mortgage-related issues, including: **Home Equity Loans: Borrowers Beware; High-Rate, High-Fee Loans; Looking for the Best Mortgage; Refinancing Your Home; and Home Equity Loans: The Three-Day Cancellation Rule.** These publications are available through the CRC or at [www.ftc.gov](http://www.ftc.gov)—click on **Publications.**

The American Association of Retired Persons has information about predatory lending. You can access information by phone: 800-424-3410; by mail: AARP, 601 E Street, NW, Washington, DC 20049; or on the web: [www.aarp.org/getans/predatorylending.html](http://www.aarp.org/getans/predatorylending.html).

<b>Federal Trade Commission</b>	<b>Toll-free 1-877-FTC-HELP</b>
<b><a href="http://www.ftc.gov">www.ftc.gov</a></b>	<b>For the Consumer</b>